



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

THE ECONOMIC BASIS OF FEDERATION IN CENTRAL AMERICA

BY HARRY T. COLLINGS

The University of Pennsylvania

One hundred years ago the independence of the Vice-Royalty of Guatemala was declared. This territory, which then constituted all of Central America, had for almost three centuries previous been a dependency of Spain. For two decades after the declaration of their independence the several states were members of a centralized government known as the United Provinces of Central America. The causes which undermined and finally brought about the disintegration of the federation are in no sense an integral part of this discussion, nor is it necessary to recount the various reorganizations, and numerous attempts at reorganization, which have marked the checkered career of these states during the century of independence now closing. The hope that a single flag should wave over a federal republic has never long been out of mind in one or more of these countries.

To plunge "in medias res"—By covenant signed in San José, Costa Rica, on January 19 of this year (1921), the states of Guatemala, Salvador, Honduras, and Costa Rica agreed to form a federation to be known as the Republic of Central America. Nicaragua was represented at this preliminary conference but declined to sign the agreement because the state did not wish to impair her treaty-making powers, under the arrangement with the United States regarding a canal across her territory. Costa Rica, too, failed by a narrow margin to ratify the covenant signed by its delegates. On September 9 last, however, in Tegucigalpa, the capital of Honduras, a constitution was signed which united the three states of Guatemala, Honduras, and Salvador into a sovereign and independent federation to be known as the Republic of Central America. Such a federation has been functioning since October 1, 1921.

So much for the historical facts as a setting. The political provisions in the new state I may omit entirely. The question for discussion here is rather: Does the economic environment in the Central American states justify federation, and if so, what phases of national development will federation promote?

The new republic has a population of over 4,000,000. Racially and economically the peoples now in the union, as well as those of

the two states which have not yet joined, are bound together by ties centuries old. The governing classes in all of the states are of Latin origin—descendants of Spanish colonists. The governed classes, with all their various proportions of whites, Indians, ladinos, and other mixtures, show remarkable similarity in religion, interests, aptitude, and native ability. Economically all the countries are confronted with the same problems—the development of their natural resources, which are largely agricultural, and the creation of facilities for placing their products more readily in the hands of the ultimate consumers, either at home or abroad. And from foreign countries must come to all alike manufactured products.

The development and exportation of Central American products, and the resultant importation of manufactured articles rest upon certain economic bases: (1) the creation of a stable government, (2) the reduction of government expenses, (3) the reform of the present currency and banking systems, (4) the creation of better conditions both for borrowers and lenders, in foreign investments, (5) the development of transportation, both railroad and shipping, (6) the extension and stimulation of foreign trade. It is the purpose of the writer to regard these as the economic bases, the establishment and improvement of which are made more feasible by the new federation, and indeed justify its existence.

One of the greatest hindrances to economic development in Central America during the past hundred years has been instability of government. This instability, it may be asserted, is political rather than economic. But government is, or should be, "for the people"; it exists merely to satisfy national wants. In Central American states, however, government has only too often existed chiefly for the benefit of professional politicians who by revolution after revolution have subverted existing régimes only to replace them by others equally unstable. The Central American mother who, pointing with pride to her young son, said that he was a likely boy and would doubtless grow up to be a "good revolutionist," may have made an uncommon assertion; the sentiment unfortunately is only too common. Nothing will contribute more to economic advancement in this territory than the substitution of some peaceful means of changing governments without the subversive and costly accompaniments of revolutionary overthrow.

In this matter the new federation has a wide field for activity.

A united republic of even three states can do much to give its inhabitants a part in the actual manipulation of government, and can protect the life and property of both natives and foreigners against aggression by any self-constituted leader. A centralized government may inspire or, if necessary, compel a spirit of compromise and respect for a minority—something unknown to revolutionary leaders. This inability to maintain a stable government in the past not only retarded social and economic progress; it has jeopardized even national existence. Incapacity or inability to secure to the life and property of foreigners that protection which modern international law demands, endangers both the sovereignty and the territorial integrity of weak nations.

The encroachments of foreign nations will have no justification if the new federation can demonstrate that the central government is permanently in control, and that this control can be changed only by the will of the people, expressed in a legal election. With an illiteracy running from 50 to 85 per cent, this means a campaign for better education; with land holdings largely in the hands of the wealthy it means a new policy of farm ownership; with a people little accustomed to government control or to legal restriction, it means an entire reorganization of civic life. This is indeed a task of no mean proportion. But if accomplished by the new federation, stabilization of government will be the first step toward a social and economic development previously unknown to this region.

But stable government alone will not introduce a millenium. Such a government must pay its way. In the reduction of expenses the new state may find a second economic basis which will justify its existence.

The heaviest expenses of Central American governments in the past have been incurred for military purposes. The constitution of the new state proposes that the army shall be exclusively under the orders of the central Federal Council and that the separate states shall maintain a police force only. It is declared to be "necessary and expedient that the Federation should reduce armaments and armies to the strictly necessary so as to return hands to farming and manufacturing." Such a program, if faithfully carried out, should reduce the total cost of military forces for the whole federation to less than it has been for any of the individual member states. To this financial advantage the constitution rightly adds the great economic advantage that will accrue when

men whose business as soldiers has been destruction are returned to fields of production. A further reduction of expenses will come from the elimination of many petty officials at home, and of foreign representatives abroad. The latter are justifiable but expensive; the former have been largely "plum-pickers" whose only justification has been that they kept out of office another horde equally greedy. It is in the power of an efficient Federation to abolish this nuisance.

The failure of Central American revenues and expenditures to balance, however, has not been due solely to the extravagance of the expenditures. Much of the difficulty may be laid at the door of inadequate and inefficient collection of revenues. Tax systems are notoriously deficient, and even the sums collected often find their way into channels entirely different from those originally intended. Too much power over public money has lain in the hands of reckless presidents and subservient congresses. These conditions the new central government can rectify (1) by including in the tax lists much taxable property and many taxable persons that have hitherto known how to evade payment, and (2) by dedicating public funds to public purposes.

In connection with the reform of public finance the new state is planning a revision of the currency and banking systems, for which purpose a special committee has been appointed. Guatemala and Honduras are still on a silver basis and the peso of each country fluctuates according to the commercial value of silver. Salvador, with a gold standard, has a different unit, the colon. Monetary conditions within all of the countries are bad. The circulating medium is old, dilapidated, and inadequate for the necessities of exchange. Specie has largely been driven from use by printing presses that have worked overtime. These conditions hamper domestic business, retard trade intercourse among the different countries, and have involved Central American exchanges in fluctuations which render foreign business transactions precarious. The fluctuation in the value of national monies has had an important bearing too on the payment of government expenses, since so much of the national income must be used to pay interest on foreign indebtedness. With the price of silver rapidly declining after 1890, receipts from import or export duties in silver remained more or less constant, while payments of interest on foreign debt increased enormously when depreciated and depreciating silver in the government coffers had to be converted into gold. If

the new Federation will establish a common monetary unit with a gold standard, reestablish paper currency with an adequate reserve, and inaugurate a banking system which aims to serve business interests, it will be taking a long step toward the promotion of economic welfare.

Thus far we have been considering interests which the Federation may promote by attention to domestic problems. But the welfare of Central American states is closely bound up with nations outside of the Isthmus. With the exception of mining resources, the prosperity of every part of the territory depends upon products of the soil. Coffee, fruit, sugar, hides, rubber, cacao, and lumber are, and of necessity will be, the life blood of progress to this region. But these are already produced in quantities far larger than domestic markets can absorb. They must, therefore, be sold abroad. On the other hand, no country in Central America is a manufacturing center, nor indeed ever will be. The "law of comparative cost" decrees that this region shall find its highest economic possibilities in producing from the soil for export and in importing in return foreign manufactures. Central America can never be self-sufficient. This implies foreign trade and, in countries as undeveloped as these are, foreign investments.

The potential wealth of the new state is enormous and the world wants the products of its plantations and forests. Central American agriculture is, of course, no stranger to foreign capital but the amounts invested are small compared with the possibilities. The task of the Federation will be to improve the conditions under which the states obtain this capital, and to afford the lending nations that security without which money hesitates to leave home. The present undeveloped state of the territory is largely due to a failure to obtain on favorable terms the means of developing resources, and of providing adequate transportation facilities for exporting and importing.

Hartley Withers has well said: "No one who writes of international finance runs any risk of being 'gravelled for lack of matter.'" The story of foreign loans to these countries is a long and sad one. It is a tale of ruinous rates of interest; a story of borrowings whose proceeds have been reduced half by scandalously high commissions, greed of local officials, or manipulations of unscrupulous speculators. From 1867-1870 Honduras contracted loans in London and Paris to the amount of £5,398,570, bear-

ing from 5 to 10 per cent interest, to build a transcontinental railroad from Puerto Cortez to the Gulf of Fonseca. But the greater part of this loan was divided between officials of the republic and the promoters, so that less than fifty miles of railroad were actually built. And these loans were made in the face of the fact that for forty years previous to 1867 the Republic of Honduras had defaulted in its portion (amounting to only £27,200) of a loan issued in 1825 to the Federal States of Central America. When a sovereign state which has for forty years been in default of a payment of £1,632 per year negotiates a foreign loan calling for an annual payment one hundred times that amount, there is either unusual temerity on the part of the issuing house or there are profits that accrue outside of the customary channels. On one occasion a Central American state agreed to pay in interest on foreign bonds 20 per cent more than the annual revenue of the country. Nor have all the misfortunes connected with foreign borrowings come from high rates of interest or from proceeds discounted by greed or dishonesty. With a strong government undeveloped resources often borrow foreign capital; with a weak government foreign capital frequently borrows the resources. From this the Isthmus has suffered. Much of the east coast is, in language, industry, and business practices, more foreign to its own capital cities than to the United States or certain European countries. Foreign capital has too often spelled foreign control.

But there is another side to this picture. The unfortunate conditions of foreign loans are not due solely to the cupidity of lenders from across the sea. The states themselves are largely to blame for their financial straits. High interest rates and heavily discounted proceeds are a natural and justifiable business practice when there is the gravest doubt about the payment of any interest at all, or even the return of the principal. On a foreign debt of Honduras, amounting to £5,398,570, as stated above, the arrears of interest, January 1, 1921, had risen to £22,326,112, or almost four times the principal sum. No interest has been paid since 1872. International financiers do not rush in where angels fear to tread, at least not without exacting something for their risks. The financial history of Guatemala shows that the country defaulted on its share of the debt of the first federation of Central America from 1825 to 1856, that after a loan of £500,000 had been made in 1869 both this and the pre-

vious debts went into default in 1876. Refunded in 1888 with a reduced principal, the government again defaulted in 1894. With reduction after reduction of the principal in refunding operations, a new loan was arranged in 1895 to be financed by a tax of \$1.50 gold on each bag of coffee exported. But three years later the stipulated tax was reduced, and the custom receipts from it were appropriated for other purposes. No interest at all was paid from 1898 to 1913.

But capital must be secured abroad. Industrial development is impossible without it. The greatest export industry of the Isthmus—the banana industry—is solely the development of a single American corporation—the United Fruit Company. Guatemala has been called, from a financial point of view, a German colony. Federation can perform a worthy service by giving the new state such standing among the nations of the world as will allure funds for the extension of industrial life. Transportation needs similar help. Such meager facilities as exist are due to foreign investments, and much needed extensions can come only from outside loans. Tegucigalpa, the capital of the new republic, has no railroad connection with either coast. To be sure this city is connected to San Lorenzo, at the Gulf of Fonseca on the Pacific, by the finest automobile highway in Central America, but the juicy ten cents a mile paid to our lawmakers journeying to legislative gatherings would lose their juiciness for the delegates to the Federal Council from the several states when the eighty-one miles by automobile cost thirteen cents gold per mile. Transcontinental railroads have been the dream of every state in this region, and their partial realization has cost millions. Guatemala possesses such a railroad, yet elsewhere in that country, as well as in Salvador, and Honduras, transportation is still largely carried on by ox-carts or mules. Railroad builders in this territory have taken thought for bananas rather than beings. Indeed, often the easiest and quickest route from one Central American country to another is via a Gulf port of the United States. Letters from San Francisco to some of these countries require more time, and are less certain of delivery, than if destined for Hong Kong or Constantinople.

Why weary with details? If the new federated government can guarantee, and substantiate its guarantee, that foreign loans will not be repudiated or swallowed up by greed and dishonesty, that interest will be paid in full, and that money loaned will be used to

build up the industries, on this one economic basis it will justify its existence.

But all economic roads in Central America lead to foreign trade. Stable government, the reduction of national expenses, the improvement of conditions pertaining to foreign loans, the establishment of adequate transportation are only steps in the right direction. Their full fruition will come when the level of living of these people is raised by the introduction of modern commodities and services purchased through the sale abroad of surplus products. No federating of states can change the character of the products. But in a region which nature has so richly endowed, the possibilities of expanding the exports and consequently the imports are practically unlimited. Let the central authorities assure the farmer that his cattle will not become the prey of a band of marauders, and this region will become one of the meat producing areas of the world; let it be made possible for silver, gold, and other minerals to reach the lanes of commerce by rail instead of on the heads of Indians or the backs of mules, and mining will develop; let the valuable woods, so useful in modern commerce, find a way to reach manufacturing centers without traveling for days at prohibitive cost over roads knee deep in mud, and lumbering will flourish. On the other hand, let textiles, machinery, flour, boots and shoes, mining materials, chemicals, electric equipment, hardware, and hundreds of manufactured products find a way to reach the common people, and the economic awakening of Central America is at hand. Vexatious tariff duties now hinder imports and hamper trade. These duties, together with fees, licenses, business taxes, petty regulations, and lack of transportation, now boost the selling price of the foreign product to from three to five times the original cost. If the new committee appointed to unify the tariff laws of the different states can establish a common tariff, permitting ready entrance to foreign products and promoting their circulation from country to country within the Republic, if it can abolish the artificial hindrances to business enterprise, the present foreign trade both in exports and imports will be doubled or trebled.

Do the economic bases of Central American life justify federation? They do. The problems of development here presented are fundamental and still await solution; but a single nation of five states, or even of the present three, with a united front and a uniform policy in commerce and diplomacy, will gain a world

position far superior to any which petty individual states, separated by the mutual jealousies and hostilities of former days, can ever hope to attain. Such a position resulting from union spells progress. The future alone will determine the success of this new Federation.